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EUR/ERA, EEB/FO, PLEASE PASS TO NSC KHELGERSON AND JHOVENIER

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TAGS: ENRG ECON EPET PGOV RU HU
SUBJECT: MOL, GOH GIRD FOR DEFENSE AGAINST RUSSIAN TAKEOVER

REF: BUDAPEST 195

Classified By: A/Pol-Econ Counselor Jon Martinson, reasons 1.4(b,d)

¶1. (C) Summary: While Hungary's political establishment has been singularly absorbed in the country's unfolding internal political drama, al--including top management at MOL--appear to have been caught off guard by the announcement on March 30 that Austria's OMV had sold its 21.2 percent stake in MOL to Russia's Surgutneftegaz. The 1.4 billion-euro purchase price equates to almost twice the closing share price prior to the transaction. Despite initial public statements by MOL supporting the Russian firm's claim that its ambitions are limited to a financial investment in MOL, company executives now publicly express their view that the transaction could be a prelude to a hostile takeover attempt. Furthermore, the transaction is viewed by many as confirmation of the widely-held suspicion that OMV was fronting for Russian interests in its attempt to takeover MOL last year. Fidesz, Hungary's leading opposition party, is accusing PM Gyurcsany's Socialist government of complicity in the transaction. In the weeks and months ahead, we expect to see MOL and the GoH use every available means to prevent such a takeover from occurring. End summary.

SURGUT PURCHASE OF OMV STAKE IN MOL STIRS THE NEST IN HUNGARY

¶2. (SBU) On March 30, Russia's Surgutneftegaz (Surgut) announced its purchase of Austrian OMV's 21.2 percent stake in MOL for 1.4 billion euro--19,212 HUF per share (approximately USD 83.50), compared to a previous-day closing price of 9,940 HUF (approximately USD 43.20). The transaction between OMV and Surgut occurred just one week after OMV CEO Ruttenstorfer told the press that OMV planned to hold onto its MOL shares at least until the end of this year. Local press reports after the transaction, however, quote an OMV spokesman saying that the company had issued an order to sell the shares several weeks ago and was surprised by how quickly the transaction was realized.

¶3. (SBU) MOL initially avoided commenting on what it officially regarded as a transaction between two private entities, but MOL CEO Zsolt Hernadi, speaking on April 1 before an extraordinary session of the Parliamentary Foreign Affairs Committee (FAC) that was called to discuss the transaction, expressed surprise that a company with no previous international presence, which had never held exploratory talks with MOL or requested financial data, would suddenly pay a nearly 100 percent premium for MOL's shares. According to Hernadi, the fact that the transaction occurred without management talks suggests that Surgut's intentions

"cannot be viewed as friendly." He also noted that the amount paid exactly matches OMV's outlays for MOL shares between 2000 and 2007, indicating probable cooperation between MV and Surgut.

¶4. (C) MOL Chairman Gyorgy Mosonyi confided to Ambassador Foley at a reception on March 31 that the company was preparing to defend itself against a hostile takeover. After describing how he first learned of the transaction in the morning newspaper, MOL chief of strategy Laszlo Varro echoed this sentiment to Econoff, saying he viewed the acquisition as having been directed from the "highest levels of the Russian government."

¶5. (C) With the transaction coming less than a month after PM Gyurcsany led a delegation to Moscow, during which the state-owned Hungarian Development Bank (MFB) and MOL each signed joint venture agreements with Gazprom, opposition leaders and some local analysts have been quick to voice their suspicion that the GoH was complicit in arranging the sale of MOL to a Russian firm. During the April 1 Foreign Affairs Committee session, Chairman Zsolt Nemeth (Fidesz) accused the government of being either "a lame duck or an agent of Russia" and called for an investigation in which National Security Office head Sandor Laborc--"with his KGB past"--and Finance Minister Janos Veres, the GoH lead on the South Stream project, should be called to testify. Local energy expert and former Hungarian Energy Office head Peter Kaderjak told the press that he found it "unimaginable that the government or the secret services had no prior knowledge of the transaction, which came at the time of the Prime

Minister's resignation."

¶6. (C) In response to such accusations, the GoH has emphatically denied having met with Surgut officials in Moscow and has registered its opposition to any hostile bid for a strategic company like MOL. Karoly Banai, Foreign Policy Advisor to the Prime Minister, told the Parliamentary FAC that the GoH had received no indication in its meetings with Austrian and Russian officials that such a deal was in the works. In a subsequent meeting with the Ambassador, Banai said that the Russians had told Gyurcsany that he would be informed in advance of any plans for an acquisition like this. Banai, who attended all the meetings in Moscow on March 10, said no such indication had been given during the recent trip or when the Austrian Chancellor was in Budapest in early March. Speaking to the press, the Russian Ambassador to Hungary, Igor Savolsky, characterized Nemeth's comments as "unacceptable and insulting" towards Russia and said he was "unaware of the Russian government ever pledging to hold political consultations about Russian companies trading on the Budapest Stock Exchange."

¶7. (C) A consensus has quickly formed around the idea that OMV had all along been a Trojan horse for the Russians, a generally-shared concern when OMV increased its stake in MOL above 20 percent in 2007. Socialist Party (MSzP) Vice President Attila Meszterhazy told Ambassador Foley on March 31 that this transaction validated the suspicions he voiced in Washington last year that OMV was acting on behalf of Russian energy interests in its earlier attempt to takeover MOL as well as the correctness of the GoH's efforts to protect this strategic company from takeover by OMV. In an office call with Ambassador Foley the same day, Hungarian Nabucco Ambassador Mihaly Bayer admitted he had no evidence to support such a conclusion, but said he believed the sale was part of an Austrian-Russian deal that will only become apparent as future events unfold. Numerous local energy experts have echoed this sentiment to Econoff in the past few days.

WHO IS SURGUTNEFTEGAZ?

¶8. (SBU) Local press coverage has described Surgut as one of

the "least transparent" firms in the Russian energy sector, close to the Kremlin, and rumored to be 37 percent owned by Putin himself. Financial analysts note that the firm's reported $20 billion cash reserve could provide significant ammunition for a protracted takeover battle.

¶9. (C) Embassy Moscow confirms that very little is known about the Russian firm, which is one of the most secretive in Russia. Attempts to meet with the company have been rebuffed. They said the ownership structure of the company is unknown and also noted rumors that the company is a source of Putin,s alleged illicit wealth. Although the company is one of the largest oil and gas producers in Russia, local investment analysts tend to qualify their assessments of its financial situation with words like "rumored" and "reported." One such rumor regards the company's $20 billion in cash on its balance sheet. Writing about the MOL acquisition, an analyst from UBS noted that "the only positive financial consideration is that the deal provides evidence that at least some part of Surgutneftegaz,s reportedly significant cash pile indeed exists." According to Embassy Moscow, local financial analysts generally believe the MOL deal to be value destructive for Surgut based on the premium it paid for the shares. Embassy Moscow also notes that rumors have persisted for some time about an impending merger between Surgut and Rosneft, the state-owned oil company. Surgut president Bogdanov,s recent nomination to the board of Rosneft adds fuel to such rumors. In such an event, the GoR would become the owner of this 21 percent stake in MOL.

... AND WHAT DO THEY WANT?

¶10. (C) Given Surgut's already significant presence on Russia's upstream oil and gas market, some observers interpret the transaction as an effort to develop a presence in Europe's downstream market. The company's own website reportedly places the acquisition in the context of a larger strategy to pursue "vertical integration," but market analysts see little opportunity for synergy between the two

companies, given MOL's small presence in Russia's upstream market and Surgut's complete absence from the European downstream. Prime Minister Advisor Banai told the Ambassador on April 1 that Surgut might be seeking access to MOL's oil refining capacity, which he says would enable the company--reportedly Russia's fourth largest oil producer--to refine 35 percent of its own oil, whereas it is currently only able to refine 20 percent of its output in Russian refineries. Banai added that Surgut may have been additionally motivated by the need to divest itself of some of its cash, lest it become a target of Kremlin maneuvering or an unsolicited takeover bid from another company. (Comment: Given the possibility that Putin has a large personal stake in Surgut, untoward moves against the company from either the political or commercial sphere seem unlikely. End comment.)

¶11. (C) Others see MOL's gas pipeline network as a more likely target. Based on the view that the company's moves have been closely coordinated with the Kremlin, our interlocutors believe the ultimate objective is to obtain a veto over any future progress on the Nabucco pipeline, given Hungary's importance as a transit country along the proposed pipeline route. MOL's Laszlo Varro told Econoff that in addition to Nabucco, MOL's plans to establish gas interconnections with neighboring countries in Central Europe would also be at risk if a Russian firm gained control over Hungary's pipeline system. Although more extensive gas interconnections might create a larger market for Russian gas, Varro notes that a truly regional market, as opposed to the fragmented national markets that exist now, would also make diversification projects such as the proposed LNG facility in Croatia more viable. The Russians, however, have an interest in preserving the status quo of smaller, more segmented markets. Balazs Felsmann, a local energy

consultant and former State Secretary at the Ministry of Transport, Communication and Energy, commented that a full takeover of MOL might not be necessary for Surgut to take control of the pipeline system. He assessed that the Russian firm might be aiming for a deal that would allow it to take the gas network while letting MOL retain its oil assets.

¶12. (C) After initially characterizing the transaction as a financial investment by Surgut, as opposed to a takeover attempt, KBC Securities analyst Peter Tordai contacted Econoff to revise his view subsequent to a local news report on the Kremlin's breach of its agreement to inform Budapest about impending major acquisitions. Citing rumors in London that the deal had been forced through by the Kremlin itself, he said "this puts the reliability of the Russians as well as their friendliness under a big question mark." He believes however, that such an aggressive approach is likely to strengthen political opposition to the deal and effectively reduce the Russian company's ability to gain influence in MOL.

¶13. (C) According to Banai, EU Energy Commissioner Piebalgs and EU Internal Market Commissioner McCreevy continue to view Surgut's move on MOL as a purely financial transaction.

EVERYBODY ON DEFENSE

¶14. (C) Despite the mutual acrimony that extends to almost every other area, there is a strong consensus between the MSzP government and Fidesz opposition regarding the need to prevent a takeover of MOL. Both MOL's Hernadi's and Varro's statements before the Parliamentary FAC that the government should help protect against a Russian takeover of the company were met with general agreement. Hernadi emphasized that MOL represents strategic energy security interests not only in Hungary, but in Slovakia and Croatia as well.

¶15. (C) According to Varro, a 10 percent cap on shareholder voting weights limits the ability of any large shareholder to gain control of the company's board of directors. Surgut could potentially vote its entire 20 percent stake if it "sold" a 10 percent stake to a friendly company such as Rosneft, and could eventually exercise additional influence through further purchases and "sales." A 25 percent stake would enable it to command a blocking minority and, thus, gain influence in MOL's strategy. However, a 75 percent vote plus GoH approval--what Varro refers to as the "nuclear option" and Banai calls Hungary's "Maginot line"--would be

needed to take over the board of directors. Varro notes that in OMV's takeover attempt, it never came close to the required 75 percent, so the GoH never had to exercise this option. (Note: This current version of "lex MOL," the legal basis for any GoH effort to prevent the takeover of a "strategic" company, reflects modifications made last year to comply with the EU competition authority's ruling against earlier GoH methods to prevent a takeover by OMV. End note.) According to KBC analyst Tordai, MOL controls about 36 percent of its own shares through direct ownership of treasury shares and stakes held by "friendly" financial institutions such as OTP, ING, MFB, and BNP Paribas. A further 14 percent is held by companies such as Czech energy firm CEZ and the Omani Oil Company, which are also "friendly" toward MOL.

¶16. (C) Varro expects the first test to come at the annual general shareholders' meeting on April 23. He noted that OMV was soundly defeated on all "important issues" at last year's meeting, after which it initiated lawsuits to contest MOL's tactic of purchasing treasury shares and lending them to "friendly institutions" to increase its voting weight beyond the 10 percent limit. Contemplating how events might play out at the meeting, he remarked that, unlike the Austrian firm, "Russians don't just call lawyers when they face obstacles."

¶17. (C) Comment MOL and the GoH, even with the "Maginot line" offered by "lex MOL," are likely o face a difficult battle if Surgut pursues a hostile takeover. Surgut is well-situated, owing to its large cash position, to wage a protracted battle and appears willing and able to pay above-market prices for MOL shares. If it decides to employ the same tactics MOL used in its battle with OMV--buying shares and selling them to allies in order to circumvent the 10 percent voting cap--a legal challenge by MOL against such "false" sales would, according to Varro, face a difficult burden of proof. This is not to mention the awkwardness of crying foul on a method MOL has itself employed. MOL's reliance on bank financing to sustain its investment in its treasury shares also could become less tenable in a tightening lending environment, as it tries to bar the door against such a well-funded and politically-connected suitor. The GoH's ability to veto changes in the board of directors may in the end suffice to prevent a hostile takeover. However, to the extent that MOL has to divert resources and attention away from capital investments in Central European gas infrastructure in order to ward off a takeover bid, Surgut's and the Kremlin's overall mission could well be accomplished. End comment.

¶18. (SBU) Embassy Budapest thanks Embassy Moscow for its contribution to this cable.
Levine